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Racketeer Influenced and Corrupt Organization Act
Summary of Testimony to Amend the Act

By John S.R. Shad, Chairman of the
U.S. Securities and Exchange Commission

Before the House Judiciary Subcommittee on Criminal Justice

October 2, 1985

This testimony supports legislation to amend the private civil liability provisions of RICO. It addresses only the civil liability provisions, not the criminal, which are within the jurisdiction of the Department of Justice.

RICO's civil liability provisions are being used primarily against legitimate businessmen and women in ordinary commercial disputes. The civil RICO problem reflects the broader problem of the rising volume and costs of commercial litigation.

RICO has also disrupted the balance of private rights and remedies under the securities laws, without the benefit of Congressional consideration of the consequences.

This testimony specifically supports:

- the H.R. 2943 proposal to require criminal conviction involving racketeering activity as a precondition to a civil RICO action;
- a uniform statute of limitations;
- a "modified English rule," under which plaintiffs would have to bear defendants' attorney fees if their actions were not "substantially justified"; and
- the H.R. 2517 proposals to change the name of RICO, and clarify the "pattern" and "knowledge" requirements.

STATEMENT OF JOHN S.R. SHAD, CHAIRMAN,
U.S. SECURITIES AND EXCHANGE COMMISSION,
BEFORE THE SUBCOMMITTEE ON CRIMINAL JUSTICE
OF THE HOUSE COMMITTEE ON THE JUDICIARY

CONCERNING

THE PRIVATE CIVIL LIABILITY PROVISIONS OF RICO

October 2, 1985

Chairman Conyers and Members of the Subcommittee:

Thank you for the opportunity to testify in support of legislation to amend the civil liability provisions of RICO, the Racketeer Influenced and Corrupt Organizations provisions of the criminal code. This testimony addresses only amendments of the civil liability provisions of RICO. The criminal aspects are within the jurisdiction of the Department of Justice.

There is substantial bipartisan support for amendment of the civil liability provisions of RICO within Congress, the Administration and the independent regulatory agencies. The Vice President's Task Group on Regulation of Financial Services has unanimously recommended that RICO be amended "to insure that its civil liability provisions are not misused by private parties in litigation involving financial institutions." 1/ The 13 members of the Task Group consisted of the Vice President; the Secretary of the Treasury; the Attorney General; the Chairmen of the Federal Reserve Board, the Securities and Exchange Commission, the Federal

1/ Task Group on Regulation of Financial Services, Report: Blueprint for Reform, 95 (July 1984).

type generally associated with professional criminals, such as arson, bribery, commercial bribery, embezzlement, extortion, gambling, theft and political corruption. 4/

Civil RICO also has had unintended effects on private enforcement of the federal securities laws. Such laws provide a variety of express and implied private rights of action. However, only compensatory damages are authorized, and awards of attorney fees are rarely allowed. By including mail, wire and securities fraud as predicate offenses, the civil RICO statute has preempted much of this field. As Mr. Justice Marshall recently pointed out, civil RICO "virtually eliminates decades of legislative and judicial development of private civil remedies under the federal securities laws." 5/

Under RICO's civil liability provisions, plaintiffs assert treble damage claims based essentially on the same evidence as for conventional securities disputes. Thus, RICO's civil liability provisions have turned virtually every securities fraud claim into a potential RICO claim, with all the incentives that RICO provides plaintiffs, including mandatory treble damages and awards of attorney fees. RICO claims in securities cases have

4/ See Report of the Ad Hoc Civil RICO Task Force of the American Bar Association Section of Corporation, Banking, and Business Law 55-56 (Mar. 28, 1985) (hereinafter "ABA Task Force Report").

5/ Sedima, S.P.R.L. v. Imrex Co., 105 S. Ct. 3275, 3295 (1985) (Marshall, J., dissenting).

The recent dramatic increase in civil RICO claims reflects a broader problem -- the significant increase in the volume and cost of commercial litigation. 8/ Tables 1 and 2 demonstrate that, for a wide cross section of companies, the average number of director and officer ("D&O") liability insurance claims increased over 270 percent from 1975 through 1983, and that the cost of defending such claims has increased over 150 percent since 1974 (over 20 percent, adjusted for inflation). Table 3 indicates that the percentage of the sample companies subject to one or more D&O claims in the previous nine years increased from 14 percent in 1974 to 33 percent in 1984. Table 4 indicates that the cost of D&O excess coverage increased over 200 percent within the 12 months ended June 30, 1985. 9/ These rapidly rising costs of business litigation are ultimately borne by American consumers, taxpayers, workers and investors, in the form of higher prices, lower corporate tax revenues, fewer jobs and lower investment returns.

2. Proposals for Amendment of Civil RICO

A number of specific suggestions have been made as to how civil RICO should be amended. These hearings were called to consider two such proposals, H.R. 2517 and H.R. 2943.

8/ See Ipsen, The Crisis in Directors and Officers Insurance, Institutional Investor, Aug. 1985, at 231; Transcript of Roundtable on Major Issues, U.S. Securities and Exchange Commission, Sept. 11, 1985.

9/ See also Ipsen, supra note 8, at 231 (since Jan. 1, 1985, D&O renewal premiums have been quoted in multiples of four to six times the previous rates).

of the mails or telephone. Indeed, a Barron's article has encouraged aggrieved investors to seek treble damages under RICO against their brokers. 11/

According to the Department of Justice, 42 percent of private RICO actions have been based on a single episode involving a single victim. 12/ This led the Department to note that "this practice is common enough to warrant concern that the purpose of the statute's 'pattern' requirement -- to limit RICO to ongoing criminal activity -- is not being fully realized" in the civil RICO context. 13/ Amendment of civil RICO is thus desirable to limit the statute to activities that characterize the perpetrators as those who have repeatedly used crime as a means to achieve their ends. Indeed, the Justice Department already imposes similar "pattern" standards in its guidelines for instituting criminal RICO actions. 14/

While declining to decide the issue, the Supreme Court, in the recent Sedima decision, suggested that the "pattern" requirement limits RICO's application to ongoing criminal activity. 15/

11/ Scheibla, Don't Pay the Two Dollars: What a Shareholder With a Beef Should Do Instead, Barron's, Aug. 29, 1983, at 15.

12/ DOJ Testimony, supra note 2, at 24.

13/ Id. at 25.

14/ Id. at 10.

15/ Sedima, S.P.R.L. v. Imrex Co., 105 S. Ct. 3275, 3285 n.14, 3287 (1985). The Court wrote that the question whether the defendant's acts fell into a pattern was not before it, but that the extraordinary uses to which civil RICO has been put in ordinary business disputes appears to result in part from "the failure of Congress and the courts to develop a meaningful concept of 'pattern'." Id. at 3287. See also id. at 3289-90 (Powell, J., dissenting).

by the same type of violation, but not necessarily the acts underlying the conviction.

Uniform Statute of Limitations

Another desirable feature of both H.R. 2517 and H.R. 2943 is the proposal to establish a uniform statute of limitations for civil RICO claims. At present, the conflicting state law periods of limitation adopted by the courts encourage forum shopping and litigation over nonsubstantive matters, such as personal jurisdiction and venue. The appropriate period will have to be determined based on the resolution of the "pattern" and predicate offense requirements.

Regulated Industry Exemption

It has also been suggested that industries subject to extensive federal regulation, such as the securities and banking industries, be exempted from civil, but not criminal, RICO. ^{17/} The rationale for this "regulated industry" exemption is that Congress has already provided pervasive statutory safeguards against repeated criminal misconduct in these industries, which are enforced by the SEC and other federal agencies, and that the remedies, including statutory bars, available under those statutes should occupy the field.

^{17/} See ABA Task Force Report, supra note 4, at 268-272.

3. Conclusion

Mr. Chairman, providing victims of repeated criminal activity with a punitive civil remedy is a desirable objective. However, the benefits civil RICO has provided to such victims have been significantly outweighed by the costs to legitimate businesses of defending suits involving ordinary commercial disputes. Changes are needed to restore balance in commercial litigation.

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